

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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CC:INTL:B05

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Date:

June 08, 2016

Parent =
Subsidiary =
CFC A =
CFC B =
CFC C =
Holdco =
Country A =
Country B =
Insurance =
Law =
Act =

Authority =
Annual =
Return =
Date 1 =
Date 2 =
Date 3 =
Month 1 =
Month 2 =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
W =
X =
Y =

Dear :

In a letter dated Date 1, you requested rulings allowing CFC A and CFC B to use certain foreign statement insurance reserves in computing their foreign personal holding company income under section 954. You requested these rulings on the grounds that these insurance reserves are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) and, accordingly, such reserves may be used in determining foreign personal holding company income under section 954.

The rulings given in this letter are based on facts and representations submitted by Parent and accompanied by a statement executed under penalty of perjury by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Facts

Parent is a publicly-traded domestic corporation that is engaged in investment banking, securities, investment management, insurance, and other financial services through its various subsidiaries. Parent is the common parent of an affiliated group of companies.

In Year 1, Subsidiary, an indirect wholly-owned subsidiary of Parent, established a wholly-owned insurance company, CFC A, under the laws of Country A. CFC A is engaged in the insurance business in Country A. In Month 1, Year 2, Subsidiary transferred all of the stock of CFC A to a wholly-owned holding company, Holdco, and sold W percent of the stock of Holdco to various unrelated parties. Parent retains an X percent ownership interest in Holdco.

In Month 2, Year 3, CFC A acquired CFC C, a company organized in Year 4 under the laws of Country A. On Date 2, CFC C changed its name to CFC B. CFC B was engaged in the insurance business in Country A. On Date 3, after the submission of the Date 1 ruling request, CFC B merged all its assets and liabilities into CFC A pursuant to a regulatory reorganization procedure applicable to Country A insurance companies. This ruling will therefore refer to CFC A but will include CFC B for the period from Date 1 through Date 3.

CFC A's operations involve the issuance of payout annuity contracts designed for the Country A defined benefit pension plan market. Prior to the merger, CFC B issued single premium payout annuity contracts for which it held reserves.

The contracts issued by CFC A are designed to provide a stream of guaranteed annuity payments to cover an employer's existing pension obligations for its Country A and Country B resident employees. The contracts cover obligations to current retirees and active employees. The source of consideration for the annuities will be a combination of employer and employee contributions.

There are no future premiums required by or allowed under the payout annuity contracts. Some contracts have surrender rights on a bulk basis (whereby the pension plan trustee of a contract may surrender the contract in exchange for a cash surrender value), and individual deferred annuitants may also be entitled to individual surrender values in lieu of future annuity payments.

Typically, a pension plan will terminate shortly after the annuity contract is purchased at which time the employee becomes the policyholder. Benefits are payable to employees only upon retirement or upon the employee's death before retirement as a spousal benefit. The employee can elect to have benefits commence earlier or later than the date of normal retirement (within a restricted range as provided by the contract). Should the employee make such an election, the amount of future benefit payments will be actuarially adjusted using actuarial assumptions guaranteed at issue so that the present value of the adjusted benefit starting on the adjusted retirement date will be equivalent to the present value of the original benefit starting on the normal retirement date.

CFC A issues premium payout annuity contracts. CFC A also issues non-single premium payout annuity contracts to Country A pension plans and enters into reinsurance agreements covering a portion of its risks under such contracts. CFC A also reinsures annuity contracts written by unrelated Country A insurers.

CFC A derives more than 50 percent of its aggregate net written premiums from the issuance or reissuance of annuities covering risks in connection with the lives of or health of residents of Country A and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person as defined in section 954(d)(3).

CFC A issues and reinsures annuity contracts in connection with the lives and health of residents of Country A and derives more than 30 percent of its net written premium from contracts that cover Country A risks with respect to which no policyholder, insured, annuitant, or beneficiary is a related person within the meaning of section 954(d)(3).

Parent has represented that CFC A would be subject to tax under subchapter L if it were a domestic corporation.

In Country A, financial services firms, including insurance companies, are regulated by the Authority. The Authority is an independent, non-governmental body, given statutory powers under the Act. The Authority requires that each insurance company authorized by the Authority to conduct insurance business in Country A file an annual insurance return. The Annual Return consists of audited financial information and reports of auditors that the Authority uses for supervision. Annual Return requirements include preparation of a revenue account, a balance sheet and profit and loss account for the year; an actuarial investigation every twelve months; an audit of

accounts; and the depositing of specific reports with the Authority. The deposited documents are open to public inspection.

CFC A is licensed by the Authority as an insurance company and is authorized to sell annuities to residents of Country A and to reinsure similar contracts. Licensing by the Authority is required in order to conduct insurance business in Country A. CFC A is subject to regulation by the Authority as an insurance company. The annuity contracts issued by CFC A are regulated as such by the Authority.

Under Authority rules, CFC A is required to maintain financial resources, adequate as to amount and quality, to ensure that there is no significant risk that its liabilities to policyholders cannot be met as they fall due. Applicable rules specify the methods and assumptions to be used by an insurance firm in calculating its required reserves.

In general, the Authority requires a firm to establish reserves using a prospective actuarial valuation on prudent assumptions of all future cash flows expected to arise under, or in respect of, each of its long-term insurance contracts. A prospective valuation sets reserves at present value of the future net cash flows. The actuarial valuation of reserves must be based on methods and assumptions that are appropriate to the business of the firm, consistent year-to-year without arbitrary changes, consistent with the method for valuing assets, and include appropriate margins for adverse deviation of relevant factors. Relevant factors include future investment returns, expenses, mortality, morbidity, policyholder options, persistency, and reinsurance.

Under Authority rules, insurance company investments generally must be marked to market, meaning valued at readily available close-out prices from independent sources. Where marking to market is not possible, assets must be marked to market using a model based on market input, and the modeled prices must be checked regularly against market or other relevant sources. Country A rules also require that reserve methods and assumptions must be consistent with the method of valuing assets or must be consistent with marking the assets to market.

The Authority has established special reserve requirements for index-linked liabilities which include CFC A's inflation-adjusted benefit described above. Index-linked liabilities are those in respect of index-linked benefits. Index-linked benefits are those provided under a long-term contract of insurance determined by reference to an index of the value of property of any description.

In addition to computing reserves as described for Country A regulatory purposes, an insurer will use the same reserve amount in calculating Country A income tax in connection with its pension plan business.

Parent represents that the reserves CFC A is required to establish under Country A rules are not catastrophe, deficiency, equalization, or similar reserves.

Parent has also represented that for purposes of determining foreign personal holding company income, CFC A would follow the Country A mark-to-market method applicable to assets under Country A financial statement rules and would base reserves only on amounts attributable to policyholder benefits if a favorable ruling is granted allowing CFC A to use foreign statement reserves under section 954(i).

Pursuant to Section 954(i)(4)(B)(ii) and Treas. Reg. §1.964-1(c)(3), Parent has requested a ruling on behalf of CFC A that the reserves as required to be set forth by CFC A for its annuity contracts on its Country A Annual Return provide an appropriate means of measuring income and accordingly, the amount of these reserves may be used in determining foreign personal holding company income under section 954, provided that assets are marked to market consistent with Country A rules and the reserve is based only on amounts attributable to policyholder benefits.

Law

In general, a United States shareholder of a controlled foreign corporation (“CFC”) must include in gross income its pro rata share of the CFC’s Subpart F income for each year. Sec. 951(a). Subpart F income includes, among other types of income, insurance income under section 953 and foreign base company income under section 954. Sec. 952(a)(1) and (2). Section 953(a) defines the term “insurance income” to include any income which is attributable to issuing or reinsuring an insurance or annuity contract and which would be taxed under Subchapter L if such income were the income of a domestic insurance company. Section 953 provides that section 953 insurance income does not include “exempt insurance income” derived by a “qualifying insurance company.” Section 953(b)(3) provides that reserves for any insurance or annuity contract shall be determined in the same manner as under section 954(i).

Section 954(a)(1) defines the term “foreign base company income” to include, among other types of income, foreign personal holding company income. Section 954(c)(1) sets forth the types of income (e.g., interest and dividends) that are considered to be foreign personal holding company income. Section 954(i)(1) provides that for purposes of section 954(c)(1), foreign personal holding company income does not include “qualified insurance income” of a “qualifying insurance company.”

In general, section 953(e)(3) defines a “qualifying insurance company” as any controlled foreign corporation which:

(A) is subject to regulation as an insurance company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance or annuity contracts to persons other than related persons (within the meaning of Code section 954(d)(3)) in such home country;

(B) derives more than 50 percent of its aggregate net written premiums from the issuance by such controlled foreign corporation of contracts covering applicable

home country risks of such corporation and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in Code section 954(d)(3)); and

(C) is engaged in the insurance business and would be subject to tax under Subchapter L if it were a domestic corporation.

Section 954(i)(2) defines the term “qualified insurance income” to mean income of a qualifying insurance company falling into two categories. The first category is income received from unrelated persons and derived from investments made by a qualifying insurance company or qualifying insurance company branch (collectively referred to as a “QIC”) either of its reserves allocable to exempt contracts or of 80 percent of its unearned premiums from exempt contracts (as both are determined in accordance with section 954(i)(4)). Sec. 954(i)(2)(A). The second category is income received from unrelated persons and derived from investments made by a QIC of an amount of its assets allocable to exempt contracts equal to: (1) in the case of property, casualty, or health insurance contracts, one-third of the premiums earned on those contracts during such year; and (2) in the case of life insurance or annuity contracts, 10 percent of the reserves described in section 954(i)(2)(A) for such contracts. Sec. 954(i)(2)(B).

Exempt contracts are defined under section 953(e)(2) to include insurance or annuity contracts issued by a qualifying insurance company in connection with the lives or health of residents of a country other than the U.S. but only if such company derives more than 30 percent of its net written premiums from otherwise exempt contracts which cover applicable home country risks and with respect to which no policyholder, insured, annuitant or beneficiary is a related person within the meaning of section 954(d)(3).

Section 954(i)(4)(B)(i) generally provides that in the case of life insurance and annuity contracts, a QIC’s reserves allocable to exempt contracts are equal to the greater of (1) the net surrender value of the contract or (2) the reserve determined under section 954(i)(5). Section 954(i)(4)(B)(ii), however, provides:

The amount of the reserves under section 954(i)(4)(B)(i) shall be the foreign statement reserve for the contract (less any catastrophe, deficiency, equalization, or similar reserves), if, pursuant to a ruling request submitted by the taxpayer or as provided in published guidance, the Secretary determines that the factors taken into account in determining the foreign statement reserve provide an appropriate means of measuring income.

Section 954(i)(4)(B)(ii) was originally enacted by section 614 of the Job Creation and Worker Assistance Act of 2002. Under the Protecting Americans from Tax Hikes (PATH) Act of 2015 (P.L. 114-113, 12/18/2015), section 954(i) was permanently

extended and made effective for taxable years of foreign corporations beginning after December 31, 2014, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end. In its Technical Explanation to the PATH Act, the staff of the Joint Committee on Taxation explains section 954(i)(4)(B)(ii) as follows:

The provision does, however, permit a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve for such contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

Joint Comm. on Taxation, Technical Explanation of the Revenue Provisions of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40) (JCX-144-15 (December 17, 2015)).

Analysis

CFC A is subject to regulation as an insurance company by Country A. CFC A is licensed, authorized, and regulated by the Authority, which is the insurance regulatory body for Country A, to sell annuity contracts to persons other than related persons (within the meaning of Code section 954(d)(3)) in Country A. Parent has represented that CFC A derives more than 50 percent of its aggregate net written premiums from its issuance of annuity contracts covering risks in connection with the lives or health of residents of Country A and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in Code section 954(d)(3)). Finally, Parent has represented that CFC A is engaged in the insurance business and would be subject to tax under Subchapter L if it were a domestic corporation. Accordingly, CFC A is a QIC.

CFC A issues annuity contracts in connection with the lives and health of residents of Country A, a country other than the U.S. CFC A derives more than 30% of its net written premiums from contracts that cover Country A risks with respect to which no policyholder, insured, annuitant, or beneficiary is a related person within the meaning of section 954(d)(3). Such contracts are, therefore, exempt contracts within the meaning of section 953(e)(2).

CFC A must establish, maintain, and calculate the reserves in accordance with rules prescribed by the Authority. CFC A must set forth the reserves on the Country A Annual Return, which must be filed annually with the Authority. As such, the reserves are the measure of the legal obligations to policyholders on the financial statement used

for regulatory purposes by life insurance companies doing business in Country A generally (whether U.S.-owned, locally owned, or owned by companies headquartered in other foreign countries). The Authority requires that CFC A hold reserves for the fulfillment of claims of policyholders and their beneficiaries. The reserves are not catastrophe, deficiency, equalization, or similar reserves. Under the rules prescribed by the Authority for determining reserves set forth on the Country A Annual Return, the method, the interest rate, the mortality and morbidity assumptions, and other factors taken into account provide an appropriate means of measuring income for Federal income tax purposes.

Rulings

Based on the information submitted and the representations made, we rule as follows:

Under the facts set forth above, the foreign statement reserves maintained by CFC A (and CFC B for years prior to the merger into CFC A) with respect to its exempt annuity contracts are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii), and accordingly, the amount of these reserves may be used in determining CFC A's (and CFC B's for years prior to the merger into CFC A) foreign personal holding company income under section 954, provided that assets are marked to market consistent with Country A rules and the reserves include only amounts attributable to policyholder benefits.

Caveats

We express no opinion on any provisions of the Code or regulations not specifically covered by the above ruling. This ruling will be subject to revocation if any of the following circumstances occurs: (1) a change in the material facts on which this ruling was based; (2) a material change in the business circumstances of CFC A which would impact its reserving method; or (3) a change in the applicable law or foreign rules relating to CFC A's current reserving method.

Procedural Statements

This ruling is directed only to CFC A (and CFC B for the period from Date 1 through Date 3). Section 6110(k)(3) provides that it may not be used or cited as precedent.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Steven D. Jensen
Senior Counsel, Branch 5
Office of Associate Chief Counsel (International)